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MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,

Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF AARP AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

LAURIE MCCANN
AARP FOUNDATION LITIGATION
601 E Street, NW
Washington, DC 20049
Tel. (202) 434-2082

BARBARA JONES*
**Counsel of Record*
AARP FOUNDATION LITIGATION
200 So. Los Robles
Suite 400
Pasadena, CA 91101
Tel. (626) 585-2628
bjones@aarp.org

Attorneys for AARP

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STATEMENT OF INTEREST[1]

AARP is a nonpartisan, nonprofit organization with a membership that helps people turn their dreams into real possibilities, strengthens communities, and fights for issues that matter most to families such as employment, healthcare, income security, retirement planning, affordable utilities and protection from financial abuse. Through education, advocacy, and service, and by promoting independence, dignity, and purpose, AARP seeks to enhance the quality of life for all. As one method of promoting independence, AARP attempts to foster the economic security of individuals as they age by seeking to increase the availability, security, equity, and adequacy of public and private retirement plans. In this regard, AARP has a longstanding interest in the operation of the securities markets because of the critical role they play in helping ensure financial security in retirement. AARP is greatly concerned about fraudulent, deceptive, and unfair business practices that can disproportionately harm older people, as well as the rights of older workers. AARP submits comments on legislative and regulatory proposals that address investment fraud, files amicus briefs in cases involving the securities laws, and opposes legislative efforts to limit the remedies of defrauded investors.

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[1] In accordance with this Court's Rule 37.6, no counsel for a party wrote this brief in whole or in part, and no person other than amicus curiae or its counsel made a monetary contribution intended to fund the brief. The parties have filed blanket waivers consenting to the filing of amicus briefs.

SUMMARY OF ARGUMENT

The decreased ability of retirees to rely on Social Security to replace wages has led more individuals to enter the securities markets, either on their own or through an employer-sponsored defined contribution plan. The unfortunate prevalence of fraud in the marketplace requires that investors have the benefit of a full range of strong, flexible legal enforcement tools including state court remedies. Federal law does not preempt the states' historic police powers in such fields as consumer and investor protection. Private remedies under state law provide vital protection for investors not available under federal law. The respective state law claims at issue in this case were enacted to protect investors, and exist in harmony with federal securities law to achieve that same purpose. State laws are a critical element available to investors to police the securities marketplace.

ARGUMENT

I. SECURITIES EXCHANGE ACT SECTION 28 PRESERVES STATE LAW CLAIMS.

"Congress has expressly preserved the role of the states in securities regulation" and "[s]tate securities laws [continue to] exist in every state, the District of Columbia and Puerto Rico . . . . " *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1107 (4th Cir. 1989). States "may provide additional rights and remedies which do not conflict with federal securities law." *Id.* (citing *Underhill Assocs.*,

Inc. v. Bradshaw, 674 F.2d 293, 295-96 (4th Cir. 1982)). The legislative history and express language of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq.*, show that a basic intent of the statute was the protection of the investing public through the "maintenance of fair and honest markets." 15 U.S.C. § 78b. In enacting the Exchange Act, Congress did not intend to cut off state law remedies. Section 28 of the Exchange Act (15 U.S.C. § 78bb) provides in relevant part that the rights provided by the Act are "in addition to any and all other rights and remedies that may exist at law or in equity."[2] Section 28 of the Exchange Act indicates that Congress contemplated and intended that persons with claims under other laws should be able to pursue those claims. "Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transaction." *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367,

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[2] Specifically Section 28 provides:

> (a)(1) Except as otherwise specifically provided in this title, nothing in this title [15 U.S.C. §§ 78a *et seq.*] shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title [15 USC §§ 78a *et seq.*] or the rules and regulations under this title [15 U.S.C. §§ 78a *et seq.*].
>
> (a)(2) Rule of construction. Except as provided in subsection (f), the rights and remedies provided by this title [15 U.S.C. §§ 78a *et seq.*] shall be in addition to any and all other rights and remedies that may exist at law or in equity.

383 (1996). If Congress had intended all federal and state claims relating in any way to securities to be the subject of exclusive jurisdiction of the federal courts, it could have so provided. It did not.

Petitioners' arguments that federal courts have exclusive jurisdiction of violations of the Exchange Act ignores Congress's express purpose in enacting the federal securities laws, which was to supplement – rather than supplant—state laws and remedies. *Zuri-Invest AG v. Natwest Fin. Inc.*, 177 F.Supp.2d 189, 191 (S.D.N.Y.2001). States retain the ability to protect investors through application of state anti-fraud laws under the express language of 15 U.S.C. § 77r (c)(1). *See also SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 461 (1969).

In *Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979)[3], this Court noted that "Thomas Corcoran, a principal draftsman of the [Securities Exchange Act of 1934], indicated to Congress that the purpose of § 28(a) was to leave the States with as much leeway to regulate securities transaction as the Supremacy Clause would allow them in the absence of such a provision." *Id.* at 182 n. 13 (citations omitted). *See also Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917).

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[3] *Superseded by statute on other grounds in* 28 U.S.C. § 1391(b)(2).

II. PRIVATE REMEDIES UNDER STATE LAW PROVIDE VITAL PROTECTION FOR INVESTORS NOT AVAILABLE UNDER FEDERAL LAW.

Allowing defrauded investors to assert their own private rights of action is "an indispensable tool . . . [and is] crucial to [maintaining] the integrity of domestic capital markets." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 321 n.4 (2007) (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)). Today, both state and federal laws regulate the purchase and sale of securities. However, state law came long before federal law and the right of investors to sue has long been a critical component of state regulation of securities.[4] As part of their enforcement scheme, state securities regulators rely heavily upon plaintiffs acting as private attorneys general, often with the benefit of fee shifting statutes, to enhance enforcement and ferret out fraud. Private plaintiffs provide states with an efficient means of increasing enforcement without increasing the size of government staffs or straining public finances.

As one commentator observes:

> "[T]he civil recovery provisions of the state securities acts serve an

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[4] Jonathan R. Macy & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 348 (1991) (States almost exclusively regulated securities sales through specialized "blue sky" statutes for "more than a generation" before Securities Act of 1933).

> important *public* function in the enforcement of these acts. The state securities agencies and criminal prosecutors simply have neither the staff nor the funds to fully enforce the acts. As a result, the investor bringing a civil recovery serves as a private attorney general. Therefore, such actions are to be encouraged."

Joseph C. Long, *12A Blue Sky Law* § 9:151.27 (2015) (original emphasis).

Congress has also recognized that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action."[5] Additionally, "private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs."[6]

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[5] H.R. Conf. Rep. No. 104-369, at 31 (1995); *see also* Francis J. Facciolo & Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges Under the Securities Exchange Act of 1934*, 1995 Colum. Bus. L. Rev. 525, 543-46 (1995) ("Section 28(a)) has been used by courts to establish the principle that the Exchange Act, whatever it may say about preemption with respect to any particular area of securities regulation, has not displaced state law in general with respect to either corporate law or securities fraud, *i.e.*, there has been no field preemption.")(footnotes omitted).

[6] H.R. Conf. Rep., *supra* note 5, at 31.

State law-based private securities litigation can provide remedies for financial wrongs not available under federal securities statutes. As an example, broker-dealers are generally not subject to a fiduciary duty under the current *federal* securities laws.[7] Congress likewise in enacting securities laws did not intend to provide a broad federal court remedy for all fraud. *See Santa Fe Indus. v. Green*, 430 U.S. 462, 479-80 (1977). In *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148 (2008), this Court repeated its caution against letting the federal securities laws interfere with the well "functioning and effective state-law guarantees" which may not be provided for under federal law. *Id.* at 161.

This Court should construe Section 27 in accordance with Section 28 so that the Exchange Act does not preclude important state law rights and remedies when doing so would not serve the purpose

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[7] Staff of SEC, *Study on Investment Advisors and Broker-Dealers*, SEC Study 54 (Jan. 2011) (emphasis added), http://sec.gov/news/studies/2011/913studyfinal.pdf. In Spring 2015, the Employee Benefits Security Administration ("EBSA") and its parent agency, the Department of Labor ("DOL"), submitted a proposed regulation titled "EBSA-2010-0050" or "RIN 1210-AB32" as an effort to "amend[ ] the regulatory definition of the term 'fiduciary' set forth at 29 CFR 2510.3-21(c) to more broadly define as fiduciaries those persons who render investment advice to plans and IRAs for a fee . . . ." Dep't of Labor, *Current Unified Agenda of Regulatory and Deregulatory Actions RIN: 1210-AB32*, Office of Information and Regulatory Affairs, http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=1210-AB32 (last visited Sept. 29, 2015).

of the statute. Since not every instance of financial unfairness or breach of fiduciary duty will constitute a fraudulent activity under § 10(b) or Rule 10b-5, the Court should be wary of foreclosing common law remedies which supplement existing federal statutes. *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987).

A. The Amended Complaint Seeks Only State Law Relief.

The operative complaint ("Amended Complaint") seeks relief exclusively under the statutory and common law of New Jersey to recover damages "as a result of Defendants' massive manipulation of the market for the price of the common stock of Escala Group". Am. Compl., attached as App. D to Pet. for Writ of Certiorari at 43a, *Manning et al., v. Merrill Lynch, et al.* "Market manipulation harms the integrity of, and thereby undermines public confidence in, securities and derivatives markets by distorting prices . . . and creating an artificial appearance of market activity." Technical Committee, IOSCO, *Investigating and Prosecuting Market Manipulation*, IOSCO Rep. 2 (May 2000), http://bit.ly/1GokTgI. Public confidence in the fairness of securities markets enhances their liquidity and efficiency. *Id.*[8]

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[8] Market manipulation is also prohibited for wholesale electricity markets under Section 222 of the Federal Power Act [16 U.S.C. § 824v] and wholesale natural gas markets under Section 4A of the Natural Gas Act. [15 U.S.C § 717c-1]. As this Court recently reaffirmed: "the Natural Gas Act 'was drawn with meticulous regard for the continued exercise of state

The Amended Complaint specifically alleges that defendants manipulated the price of stock by manufacturing "fictitious and unauthorized phantom shares". (Am. Compl. ¶ 4). The Amended Complaint acknowledges that the allegations of market manipulation constitute violations of both state and federal law. Rule 10b-5 specifically prohibits fraud and misrepresentation in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5. Additionally, the Amended Complaint includes allegations that could constitute a violation of SEC rules regulating the practice of short selling stock.[9]

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power, not to handicap or dilute it in any way.' *Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n of Ind.*, 332 U. S. 507, 517-518, 68 S. Ct. 190, 92 L. Ed. 128 (1947); see also *Northwest Central*, 489 U. S., at 511, 109 S. Ct. 1262, 103 L. Ed. 2d 509 (the "legislative history of the [Act] is replete with assurances that the Act 'takes nothing from the State [regulatory] commissions'" (quoting 81 Cong. Rec. 6721 (1937))." *Oneok, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591, 1599 (2015).

[9] A "short sale" is "a sale of a security that the seller does not own" or a sale that "is consummated by the delivery of a security borrowed by or on behalf of the seller." "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed.Reg. 61,666, 61,667 (Oct. 17, 2008); *see also* 17 C.F.R. 242.203(b). While there is no specific private right of action to remedy a violation of SEC rules regarding the short selling of stock, "abusive 'naked' short selling as part of a manipulative scheme," can be maintained because such schemes are "always illegal under the general antifraud provisions of the federal securities laws . . . " "Naked" Short Selling Antifraud Rule, 73 Fed. Reg. at 61,667.

Notably, the Amended Complaint, however, does not assert a federal cause of action. *See* Pet.App. 82a-101a (Am. Compl.¶ 88-161). The Amended Complaint contains ten causes of action detailing violations of New Jersey law including common law theft and fraud.

Petitioners emphasize the allegations in the Amended Complaint that reflect violations of the Exchange Act and its rules and regulations (Pet.Br. 20-21) but completely ignore the state claims apparently hoping that these claims will magically disappear if removed to federal court. Neither the Exchange Act, nor any Commission rule or regulation, purports to displace state law. "To the contrary, in the Act Congress several times indicated its intention that state law should apply where the Act does not." Brief for U.S. as Amicus Curiae Supporting Respondents at 10, *Lynch v. Ware*, 414 U.S. 117 (1973) (No. 72-312), 1973 WL 173812 (citing 15 U.S.C. § 78bb(a)).

Additionally, federal courts are courts of limited jurisdiction. *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994). As a result, removal statutes are to be strictly construed, with all doubts resolved in favor of remand. *See, e.g., Abels v. State Farm Fire & Cas. Co.*, 770 F.2d 26, 29 (3d Cir. 1985). The Third Circuit in this case correctly held that federal-question jurisdiction was lacking based on a complaint grounded in state law claims. *Manning v. Merrill Lynch Pierce Fenner & Smith Inc.*, 772 F.3d 158, 163-64 (3d Circ. 2014) (citing *Christianson v. Colt Indus. Operating Corp.*, 486 U.S.

800, 810 (1988) ("[A] claim supported by alternative theories in the complaint may not form the basis for [federal] jurisdiction unless [federal] law is essential to each.").

III. COMPLEX SECURITIES CREATE CONSIDERABLE CHALLENGES FOR INVESTORS.

A. An Increasing Number of Individuals Must Rely on Securities for A Secure Retirement.

The number of investors owning individual stocks and mutual funds has grown enormously in the last several decades. The decreased ability of retirees to rely on Social Security to replace wages has led more individuals to enter the securities markets and unfortunately many older investors are targeted for fraud. This era in the investment arena presents an unusually difficult environment for the individual investors who shoulder the primary responsibility for making appropriate investment choices to assure adequate income to fund their retirement years. According to the latest public data available from the Investment Company Institute (ICI), more than fifty-three million U.S. households, or about forty-three percent, owned mutual funds in 2014. Daniel Schrass & Michael Bogdan, *Profile of Mutual Fund Shareholders, 2014*, ICI Research Report 5 (Feb. 2015).[10] The median age of

[10] https://www.ici.org/pdf/rpt_15_profiles.pdf.

individuals heading households that owned mutual funds was 51. *Id.* at 9.

Although self-reported stock ownership has trended downward since 2007, when sixty-five percent of Americans owned stock, more than half of adult Americans still continue to rely on the stock market to help fund their retirement. *Id.* A recent ICI survey of the mutual fund industry showed that the combined assets of the nation's mutual funds totaled $15.9 trillion, approximately 89 percent of which was held by individuals (as opposed to financial institutions, nonprofits, and other institutional investors). ICI, *2015 Investment Company Fact Book* 29 (55th Ed. 2015), https://www.ici.org/pdf/2015_factbook.pdf.

In the years to come, Social Security is projected to provide proportionately less retirement income as a percentage of prior earnings compared to its role in earlier times. Alicia H. Munnell, *The Declining Role of Social Security*, B.C. Ctr. for Retirement Res. No. JTF6 1 (Feb. 2003)[11] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=556792 (reporting that this replacement rate will continue to drop from 41.2% for a "medium earner" who retired at sixty-five in 2000 to 36.5% by 2030; *see also* Barbara A. Butrica et al., *This Is Not Your Parents' Retirement: Comparing Retirement Income Across Generations*, 72 SSA Bull. No. 1, 37 (2012)[12] ("[B]ecause postretirement incomes are not expected

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[11] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=556792.

[12] http://www.ssa.gov/policy/docs/ssb/v72n1/ssb-v72n1.pdf.

to rise as much as preretirement incomes, baby boomers and GenXers are less likely to have enough postretirement income to maintain their preretirement standard of living compared with current retirees.". At the same time, relatively few private sector employers provide traditional defined benefit pension plans, and more employees rely on defined contribution plans. Barbara A. Butrica et al., *The Disappearing Defined Benefit Pension and Its Potential Impact on the Retirement Incomes of Baby Boomers*, 69 SSA Bull. No. 3, 1 (2009).[13]

B. Fraud Remains an Enormous Problem for Older Investors.

State laws and state securities regulators are a critical element of the institutional arsenal available to police the marketplace. *See, e.g., Not Born Yesterday: How Seniors Can Stop Investment Fraud: Hearing Before Sen. Special Comm. on Aging*, 109th Cong. 21 (2006) (statement of Patricia D. Struck, former Pres. of N. Am. Sec. Admin. Ass'n & Wis. Sec. Div. Admin.).[14]

As former Senator Kohl confirmed:

> "[M]any seniors are turning to investments to increase their retirement income . . . [and] are proving too easy prey for con artists ready to steal their hard earned

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[13] http://www.ssa.gov/policy/docs/ssb/v69n3/v69n3p1.pdf.

[14] http://www.aging.senate.gov/imo/media/doc/3292006.pdf.

> and harder to replace money. . . Regardless of the scam, the outcome remains the same: seniors lose their irreplaceable retirement income."

Not Born Yesterday: How Seniors Can Stop Investment Fraud: Hearing Before Sen. Special Com. on Aging, 109th Cong. 1 (2006) (opening statement Sen. Kohl).[15]

While the character and harmful market effects of market manipulation are well known, the incentives, means and opportunities for carrying out manipulative schemes continue to evolve as developments in technology have created new opportunities for market manipulation.[16] Never have state enforcement actions been more essential to the protection of older investment fraud victims. State laws are a critical element of the institutional arsenal available to police the marketplace. In enacting the Exchange Act, Congress did not intend to cut off state law remedies. 15 U.S.C. § 78bb.

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[15] http:// www.aging.senate.gov/imo/media/doc/3292006.pdf.

[16] IOSCO, *Addendum to IOSCO Report on Investigating and Prosecuting Market Manipulation*, IOSCO Rep. 1 (2013), http://bit.ly/1Pysuw6.

CONCLUSION

For the foregoing reasons, the decision of the Third Circuit should be affirmed.

Respectfully submitted,

Laurie McCann
AARP Foundation
Litigation
601 E Street, NW
Washington, DC 20049
Tel. (202) 434-2082

Barbara Jones*
**Counsel of Record*
AARP Foundation
Litigation
200 So. Los Robles,
Suite 400
Pasadena, CA 91101
Tel. (626) 585-2628
bjones@aarp.org

Attorneys for AARP